

It's Your Money
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As Iowa's State Auditor, I serve as your watchdog of the State treasury. I serve all voters in Iowa – all Democrat, Republican, and no party registered voters. It is my job to give you an independent, honest assessment of Iowa's financial affairs; and, to do that in a clear and understandable way. As State Auditor, I also help ensure your tax dollars are spent effectively and efficiently. I take my role very seriously. Remember, there is no such thing as "government money." There is only your money - "taxpayer money!"

My observations:

◆ **We must face reality – we have a budget problem**

In two out of the last three years, Iowa has ended the fiscal year with a budget deficit. Simply put, actual spending exceeded actual revenues in two of those three years. Much of the focus (or blame) for these budget deficits has been directed at the Revenue Estimating Conference (REC), the three-person panel that estimates revenue. When you look at the last eight fiscal years, however, the REC estimated revenues have been within a plus or minus 2% of projected revenues. Whenever your actual revenues come in at 98% of what you projected, that's very good. The real issue isn't how much we have budgeted to receive, but how much we have budgeted to spend. For example, in Fiscal Year 2003 we had a \$4.5 billion General Fund budget, but only a \$2 million cushion built into the budget. While \$2 million sounds like a lot of money, let me put this in perspective for you. It's like a family with a \$45,000 annual income that budgets to spend every dollar - except for one \$20 bill! All it takes is one higher than anticipated heating or cooling bill, or some other unexpected expense, and this family has a deficit. Iowa cannot budget to spend all of its estimated revenues; this budgeting does not allow for variances that will inevitably occur in revenue projections.

◆ **Balanced?**

But even with all of that, I'm sure you have heard many times over the past few years "we balanced the budget." Yes, "technically" the budget has been balanced, but no one ever tells you how we balanced the budget. The key is how the budget was balanced. If we look at the last four fiscal years the numbers are quite astounding. Let's start with the cash surplus and cash reserve accounts. At the end of Fiscal Year 1999 the State had \$410 million of cash surplus and \$440 million of cash reserves. At the end of Fiscal Year 2003, just four short years later, the cash surplus was depleted and cash reserves were down to just \$161 million. With cash surplus and reserves at only \$161 million at the end of Fiscal Year 2003 compared to over \$850 million just a few years ago, Iowa has been forced to borrow for cash flow purposes in Fiscal Year 2004.

There's much more, however, to the story of Iowa's balanced budgets. During the same four-year period, the State borrowed \$439 million from other funds that must be repaid under current law. This \$439 million represents approximately 10% of our General Fund budget, yet no repayment plan for these monies has been addressed. In addition to borrowing from the Cash Reserve and Economic Emergency Funds, the Executive and Legislative branches tapped the Senior Living Trust Fund for a loan, a fund created to provide Iowa's senior citizens with at-home comprehensive long-term care alternatives to institutional care. This Fund has loaned more than \$50 million to cover General Fund operating costs. The cumulative borrowings from other funds by fiscal year are as follows:

	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>
Cash Reserve Fund	\$ -	90.0	64.5
Economic Emergency Fund	66.1	216.0	222.7
Tobacco Settlement Trust Fund	64.6	100.5	100.5
Senior Living Trust Fund	-	51.5	51.5
Total	<u>\$ 130.7</u>	<u>458.0</u>	<u>439.2</u>

Source: Legislative Fiscal Bureau

But wait, it gets even worse. Another \$564 million has been raided from more than thirty other funds and special accounts. The State hasn't addressed whether it will or will not repay these amounts. For example, another \$89.2 million has been taken from the Senior Living Trust Fund and \$39.5 million has been taken from the Environment First Fund, a fund established to protect, conserve, enhance, or improve Iowa's natural resources or the environment. If these cumulative amounts are not repaid, what's the impact to the Senior Living Trust Fund, the Environment First Fund, and all the other funds and special accounts summarized below?

	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>
Tobacco Settlement Trust Fund	\$ -	74.3	191.8
Senior Living Trust Fund	-	22.5	89.2
Other:			
Underground Storage Tank Fund	-	18.0	48.0
Environment First Fund	-	17.6	39.5
Rebuild Iowa Infrastructure Fund	-	9.8	31.2
Regents Demutualization	-	-	30.0
School Infrastructure Fund	-	-	22.0
Reserve Fund Interest	-	15.6	20.8
Hospital Trust Fund	-	7.0	19.0
Prison Infrastructure Fund	-	6.2	13.8
Insurance Premium Tax	-	-	10.0
Recreation Trails Fund	-	5.5	5.5
Ground Water Protection Fund	-	4.2	5.2
Waste Tire Fund	-	3.0	4.6
Vehicle Depreciation Fund	-	2.2	4.4
Enhanced Court Collections	4.0	4.0	4.0
Terminal Liability Fund	-	3.5	3.5
DED - Strategic Investment Fund	-	3.0	3.0
Title Guarantee Fund	-	-	2.7
DED - Physical Infrastructure Assistance Fund	-	2.5	2.5
TRANS Notes Interest	-	2.3	2.3
Risk Pool	-	1.5	1.5
Ag - Alternative Drainage Assistance Fund	-	1.1	1.1
Jury and Witness Fund	-	-	1.0
Brucellosis and Tuberculosis Fund	-	1.0	1.0
DNR - Snowmobile Fund	-	1.0	1.0
Victims Compensation Fund	-	1.0	1.0
All Terrain Vehicle Fund	-	0.8	0.8
DED - Value Added Agriculture Fund	-	0.3	0.3
Aviation Assistance Fund	-	0.3	0.3
Other Fund Transfers	-	1.7	2.6
Subtotal Other	<u>4.0</u>	<u>113.1</u>	<u>282.6</u>
Total	<u>\$ 4.0</u>	<u>209.9</u>	<u>563.6</u>

Source: Legislative Fiscal Bureau

Do you know what all this means? In just four short years, the State has spent an alarming \$1.4 billion more than we have collected. That's roughly one-third of Iowa's annual General Fund budget. As I tell people - when you are digging a hole and can't see out, you had better stop digging!

◆ **Iowa doesn't have a REAL 99% spending limitation**

Iowa has a law limiting spending to 99% of projected revenues. In recent years, however, the Executive and Legislative branches have passed budgets to spend more than the 99%. Why? Because the current 99% spending limitation only applies during the original budget process and regular legislative session. The 99% spending limitation does not apply during a special session or when making supplemental appropriations. Worse yet, the Executive and Legislative branches have repeatedly used the term "notwithstanding" in bills which allows them to "ignore" the 99% spending limitation, and several other legal requirements they choose not to follow.

◆ **Too much reliance on "one-time" or "limited-time" resources**

Iowa has faced some difficult economic times. While the Cash Reserve Fund and the Economic Emergency Fund were set up to provide a "safety net" during tough times, approximately \$400 million of cash surplus has been spent and more than \$1 billion borrowed or taken from other funds or special accounts in the last few fiscal years. I have great concerns about these revenue transfers and expenditure shifts. Not only the dollar amounts involved, but the fact that these shifts and transfers have become the practice rather than the exception. Iowa has had four consecutive years of significant revenue transfers and expenditure shifts, not including the more than \$150 million incorporated into the Fiscal Year 2004 budget. While one could argue that such transfers and shifts were necessary on a short-term basis, now is the time to eliminate our reliance on these resources. Couple this reliance on one-time or limited-time resources with the Executive and Legislative branches' failure to develop a repayment plan for any of the borrowings, and my concerns increase.

My recommendations:

◆ **Implement the sound budgeting principles outlined by the Iowa Taxpayers Association.** During the last legislative session both the Executive and Legislative branches talked about these principles but did little to implement them. Those good budgeting principles are as follows:

1. Avoid the use of one-time or time-limited sources for ongoing expenses
2. Avoid implementing new programs for a partial fiscal year
3. Avoid multi-year accelerating commitments
4. Avoid new automatic, or "standing" appropriations
5. Accurately determine revenue and expenses
6. Align expenses and revenue in the same fiscal year
7. Avoid shifting program funding to property taxes or fees

◆ **Implement and follow a TRUE spending limitation**

We must have a real spending limitation that applies for the entire fiscal year without exception. Yes, we need to decide if that spending limitation should be 98% or 97%, but let's follow the limitation. The Executive and Legislative branches must have the discipline to follow the spending limitation. It sets a terrible precedent when revenues are down and State

government elected leaders repeatedly spend more than we take in. What's to stop them from spending more than current revenues when the economy strengthens again?

◆ **Develop and implement a repayment plan for borrowings**

It is critical that a repayment plan be developed and adhered to for the \$439 million of borrowings. These repayment expenditures must be incorporated into the General Fund appropriations. Without a repayment plan that is adhered to, these obligations could be deferred indefinitely. It's like having a home mortgage, but there are no required repayments. How many individuals would possess the self-discipline to make monthly payments?

◆ **Evaluate other funds raided**

It is essential that an evaluation be conducted of the assets and liabilities related to the other funds and special accounts from which the \$564 million was taken. Iowa must assess the impact to the services provided by these funds and special accounts if the amounts are not repaid. If it is decided that any amounts will not be repaid, they should be reported. The taxpayers of Iowa deserve to be informed of such intended actions that impact resources originally accumulated for other purposes, but that were later shifted to General Fund expenditures without providing for repayment.

◆ **Take a longer-range focus**

When the primary focus is on a single-year budget, it is very easy to shift financial burdens to future years – a shift that does not receive the careful, thoughtful process any such financial burden shift should generate. Proof? Look how quickly we spent \$1 billion from other funds and special accounts and accumulated borrowings that must be repaid totaling \$439 million. Sound fiscal policy dictates that a longer-range perspective is needed in our budgeting and fiscal planning process.

◆ **Add clarity to the budget**

I've been a CPA for over 25 years and have audited large corporations as well as small businesses. I must admit I found evaluating the State's budget very difficult. So many times, there are transfers of certain revenues, or shifts of certain expenditures from one source to another in one budget year but not another. When this happens, it makes the comparison of fiscal years virtually impossible—it's like comparing apples and oranges. The only way to appropriately make valid comparisons that can aid lawmakers is to bring clarity to the budgeting process. That means the "true total cost of the General Fund" – regardless of where the expenditures are shifted – should be presented in an easy and understandable format. A budget document with enhanced clarity will provide the type of comprehensive information that is so vital in making good, sound financial decisions that will hold up in the long-term.

Now is the time to focus on rebuilding Iowa's financial condition. We can no longer postpone the difficult decisions. It is critical that we set specific financial goals, and then establish timelines for achieving these goals. I urge each of you to stay informed about Iowa's finances and communicate your thoughts with your elected officials. I pledge I will continue to do my very best to provide you with a clear and independent assessment of the financial facts.

If you have comments on this or other issues, I would appreciate hearing from you. You can call me at 515-281-5835, email me at david.vaudt@auditor.state.ia.us, or visit my website at www.state.ia.us/government/auditor.